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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1930. No. 203.

DAVID BURNET, Commissioner of Internal Revenue,
Petitioner,

v.

WILLIAM HOBART PORTER and ANDREW W. PORTER, Executors of the Estate of WILLIAM W. PORTER, Deceased.

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR RESPONDENTS.

WALTER LEE SHEPPARD,
WILLIAM C. ALEXANDER, JR.,
1500 Walnut Street,
Philadelphia, Pa.,
Attorneys for Respondents.

FOULKROD, SHEPPARD, PORTER & ALEXANDER,
1500 Walnut Street,
Philadelphia, Pa.,
Of Counsel.

Lawyers' Book Printing Co., 825 Walnut St., Philadelphia, Pa.

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OPINION BELOW.

The Opinion of the Circuit Court of Appeals (R. 55) is reported in *39 F. (2d) 360.* The opinion of the Board of Tax Appeals (R. 14) is reported in *13 B. T. A. 279.*

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered March 18, 1930 (R. 57). The petition for writ of certiorari was filed in this Court on June 18, 1930 (R. 57). Certiorari was granted October 13, 1930.

STATEMENT.

The facts in the case are identical with those in *David Burnet, Commissioner of Internal Revenue, Petitioner, v. Samuel F. Houston, No. 199, October Term, 1930,* now pending in this Court, except that the amount paid over to the Real Estate Trust Company, in conjunction with Samuel F. Houston and others, by the decedent, William W. Porter, was $75,000 (R. 11). Judge Porter received 54 shares of Pennsylvania Sugar Company stock in 1921 (R. 13), the value of which was $150. per share, or $8,100; making a difference of $66,900. for which he claimed a loss. He did not deduct this loss at the time of filing his return, but paid the tax under protest, and filed a claim for its refunding, which was subsequently allowed by the Commissioner by letter dated August 21, 1923, and thereafter paid. Two and a half years later, the Commissioner revoked his action, and determined a deficiency on the theory that the loss so claimed was not deductible.

The amount of the tax deficiency involved is $7,268.60 (R. 10).

ARGUMENT.

The main issue involved in this case is the same as that which has been completely covered in the brief filed on behalf of the respondent in *David Burner, Commis-*

sioner of Internal Revenue, Petitioner, v. Samuel F. Houston, No. 199, October Term, 1930, now pending in this Court on a writ of certiorari to the Circuit Court of Appeals for the Third Circuit. The Court is respectfully referred to the very complete argument there presented, which will not be repeated, but merely supplemental, here.

The finding of the Board of Tax Appeals, which the petitioner seeks to sustain, is predicated on the following statement as its foundation: "In consideration of the money subscribed and paid to the so-called guarantee fund, each subscriber thereto acquired certain rights which were henceforth his property and which cost is the amount of his subscription." (Transcript of Record, page 24.) In consequence, the Board holds that the March 1, 1913, value of these "rights" becomes the basis for ascertaining gain derived, or loss sustained, under the provisions of Section 202 (a) 1 of the Revenue Acts, and the decisions of the *United States Supreme Court in Goodrich vs. Edwards, 255 U. S. 527,* and similar cases.

In this fundamental conception of the facts, as the Circuit Court of Appeals has found, the Board of Tax Appeals failed to comprehend the precise nature of the transaction. In the Findings of Fact, the fund in question is called a "guarantee fund", and the purpose of the subscriptions is stated to be "to guarantee a value of $3,000,000 for Segal collateral" (Transcript of Record, page 18). It is obvious that the rights resulting to the subscribers were not of a character such as the property right acquired by the taxpayer in *Goodrich vs. Edwards, supra,* which consisted of the outright ownership of a number of shares in a mining corporation. Similar to *Goodrich vs. Edwards,* are the other cited cases, wherein the property rights involved are all of the same nature; namely, the ownership of liquid, transferable securities. In the instant case, on the other hand, as stated in the Findings

of fact, the taxpayer did not acquire absolute title to a chose in action, but he acquired a right to receive a pro rata share in the proceeds of certain assets, uncontrolled by him, when liquidated at an indefinite time in the future, and in a certain contingency.

The taxpayer's subscription was precisely what it was called, that is, a guarantee. The responsibility of the guarantor was assured by the deposit of cash, but the event which determined his gain or loss was not expected to occur until a very long time subsequent to his subscription. It was the very kernel of the plan that the subscriber should be afforded the opportunity of realizing the value inherent in these assets, which, on account of non liquidity, were unacceptable to the banking department, and had therefore caused the closing of the doors of the trust company. Had the subscribers signed a blanket bond to guarantee the Segal assets and deposited the amount of their subscriptions with another banking institution to guarantee fulfillment of the obligation, it is submitted that the legal effect of the transaction would have been the same. The subscribers, therefore, did not acquire a property right, in the sense that the term is used by the Board, at the time of their subscriptions, but, on the contrary, engaged to guarantee a certain value at an uncertain future time, to certain specific assets of the Real Estate Trust Company, which guarantee was backed by the deposit of cash.

Viewed in this light, it is obvious that the transaction does not become closed, nor does gain or loss become determinable, until the conditions of the obligation are fulfilled, to wit: the liquidation of the Segal matters and the restoration of the capital and surplus of the Real Estate Trust Company. At no sooner date does the condition of the guaranty become determined or the amount become capable of liquidation. The petitioner does not allege that the respondents have suffered no loss,

nor does the Board of Tax Appeals hold this. The only difficulty arises as to the ascertainment of the time when the loss occurred. That time certainly, in this situation is when the transaction is completed.

For the reasons above outlined, the determination of a value as of March 1, 1913, was irrelevant. But were it otherwise, and the burden of proving it rested on the respondents, that burden has been met. There being no presumption as March 1, 1913, value, and the burden of proof resting on the taxpayer, this burden must necessarily be a light one. It is pointed out in *Lucas vs. Alexander, 279 U. S. 533,* in applying Section 202 (a) 1, with reference to an asset which had no market value on March 1, 1913, and was not assignable, that the purpose of ascertaining the value on the basic date was merely to measure the part of the total gain or loss which had arisen prior and subsequent to the basic date, and, as respects property without market value, the fair value on said date is not necessarily what might have been then realized upon it by a forced liquidation, but rather its fair accrual value.

The fact that, in 1915, the contributing directors went to John G. Johnson, Esquire, and obtained an opinion from him as to the operation of the fund, and subsequently entered into a supplemental agreement concerning it in 1916; coupled with the unqualified statement of Mr. Houston to the effect that in 1916, it was his opinion that, assuming the anticipated success of the Sugar Company, the Segal assets would work out a fund sufficient to return to the subscribers the amounts of their contributions; clearly indicates that the admitted loss realized in 1921 must have occurred between 1916 and 1921. In the absence of other evidence, this would amply support such a finding, and would satisfy the burden of proof, if it rested on the respondent.

Under the issue as here raised, however, it is earnestly contended that the burden of proof rested on the Commissioner. Unlike Samuel F. Houston, Sallie H. Henry, and other taxpayers involved in the transactions here under consideration. William W. Porter paid his tax for the year 1921 under protest, and filed a claim for refund based upon the loss herein in controversy. After a thorough examination, this claim was allowed by the Commissioner of Internal Revenue, petitioner herein, who subsequently refunded the tax paid, in the year 1923. In 1926, the petitioner sent a deficiency letter to the effect that the Solicitor had changed his ruling, and that the loss was improperly allowed. Then William W. Porter died on November 16, 1928.

A clearer case of the misuse of discretionary powers upon the Commissioner could hardly be found. Judge Porter honestly and fairly paid the tax, and assumed the burden of its recovery. Nearly three years after he had successfully discharged this burden, the Commissioner determined a deficiency. Now, after the death of the taxpayer, his executors are obliged to contest the liability. The Circuit Court of Appeals held that such procedure on the Commissioner's part is justified under the law. (*See opinion of Woolley, J., 39 F. (2d) 360.*) It is submitted, however, that good faith requires that repose from tax should occur at a reasonable date in the absence of some compelling cause to the contrary, and that the estate of this taxpayer should not be required to again bear the burden of proof in the case, but that the burden of proof should now shift to the Commissioner, to establish his former error and justify his new position.

No fraud, or mistake, or additional fact, entered into the redetermination. What was said in the opinion of Lansdon (dissenting on another point) in the case of *James Couzens vs. Commissioner of Internal Revenue, 11*

B. T. A. 1040, involving the value of the Ford Motor Company stock, may be repeated here with even greater force, namely, "I cannot subscribe to the theory that moral considerations are not within the domain of the judgment of this Board and of all government agencies * * *. There was an understanding, to which the government was a party, that the valuation made by Roper should be the basis of a tax to be paid to the government. The parties complied with the terms of that understanding. I believe that the public interest requires that the government stand by its valuation. * * * I * * * am convinced that our decision here will be more consonant with just conceptions of public policy if it recognizes the moral obligation of the Treasury to accept as conclusive the acts of its agents when it is established, a in this proceeding, there is neither fraud nor gross error, either in the method employed or the results reached." See also the opinion of Morris, J., in *McIlhenny, et al., v. Commissioner of Internal Revenue, 39 F. (2d) 356.*

In *Anderson v. United States, 269 U. S. 422*, the rule was established, which has since been re-iterated and consistently followed, that "Since the suit was one to recover a tax erroneously exacted, the burden was on the petitioners, appellees here, to prove the facts establishing the invalidity of the tax." This burden Judge Porter assumed and completely discharged in his lifetime. The resulting determination in his favor was a judicial finding, which, except for the peculiar provisions of the Statute here involved, would be conclusive upon both parties, as in the case of any final judgment of a competent court. If the Commissioner, as the representative of the government, is to be accorded the right to revoke and annul his own determination nearly three years later, and to claim back from the taxpayer's executors the very moneys which he repaid to the taxpayer on his successful establishment

of his claim of refund, then the Commissioner should be required to prove his claim. The taxpayer having once thus discharged his burden, it is respectfully submitted that it is contrary to reason and equity that he should be called upon to discharge it again as a pre-requisite to the retention of the money so refunded to him. On the contrary, the positions of the parties are now reversed, and in the absence of sufficient evidence to support a contrary finding, the executors of the estate of this taxpayer are entitled to the protection of the Commissioner's original determination.

Respectfully submitted,

WALTER LEE SHEPPARD,
WILLIAM C. ALEXANDER, JR.,
Attorneys for Respondent.

FOULKROD, SHEPPARD, PORTER & ALEXANDER,
Of Counsel.